



ARIZONA STATE RETIREMENT SYSTEM

3300 NORTH CENTRAL AVENUE • PO BOX 33910 • PHOENIX, AZ 85067-3910 • PHONE (602) 240-2000
4400 EAST BROADWAY BOULEVARD • SUITE 200 • TUCSON, AZ 85711-3554 • PHONE (520) 239-3100
TOLL FREE OUTSIDE METRO PHOENIX AND TUCSON 1 (800) 621-3778

*Paul Matson
Director*

MINUTES PUBLIC MEETING ARIZONA STATE RETIREMENT SYSTEM BOARD

**Friday, December 1, 2017
8:30 a.m.**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room of the ASRS Office, 3300 N. Central Avenue, Phoenix, Arizona 85012.

Mr. Kevin McCarthy, Chair of the ASRS Board, called the meeting to order at 8:30 a.m.

The meeting was teleconferenced to the ASRS office at 4400 E. Broadway, Tucson, Arizona 85711.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Kevin McCarthy, Chair
Mr. Michael Miller
Mr. Clark Partridge
Mr. Jim Hillyard
Mr. Michael Lofton
Mr. Mr. Rene Guillen (Joined the meeting at 8:31 a.m.)

Absent: Tom Manos, Vice-chair

Two vacant positions.

A quorum was present for the purpose of conducting business.

2. Approval of the Minutes of the October 27, 2017 Public Meeting of the ASRS Board.

Motion: Mr. Michael Lofton moved to approve the minutes of the October 27, 2017 Public Meeting of the ASRS Board. Mr. Jim Hillyard seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 1 excused, and 2 vacancies, the motion was approved.

Mr. Rene Guillen joined the meeting at 8:31 a.m.

3. Presentation, Discussion, and Appropriate Action Regarding ASRS Legislative Initiatives and Legislative Update

Ms. Jessica Thomas, Government Relations Officer, introduced the topic by stating that at the October 27, 2017 Board meeting the Board approved the 2018 Legislative agenda. Ms. Thomas provided an update on the following ASRS legislative initiatives:

Amend A.R.S. § 38-718 to exempt all investment related services from the procurement code. Ms. Thomas has worked closely with staff at ADOA and the State Procurement Office as well as reaching out to the Attorney General's Office to amend the language of the statute as of the last Board meeting on October 27. The new language states that the Board may enter into a contract utilized directly for investment related services for the purpose of exercising the investment responsibilities described in this article and article 2.1. The new language has also removed reference to A.R.S. § 35-214 and A.R.S. § 38-511.

Amend A.R.S. § 38-751 to include information about how the Non-Participating Employer Liability is calculated and charged and to whom it is assessed. The language of subsection A of this bill has been amended to exempt particularly the state, as well as charter schools from the statute. Subsection A-B was also amended to clarify that the reduction in employees does not include employees who are participating in another state retirement plan. The ASRS is currently working with Legislative staff to obtain a sponsor for this bill.

Ms. Thomas stated that the last two initiatives of the 2018 Legislative agenda have not been amended since the last Board meeting on October 27. The two bills are as follows:

Amend A.R.S. § 38-701(6) to allow the Governor's Office to name any state agency as the state social security administration.

Amend A.R.S. § 38-871 to reorganize Deferred Compensation Committee members and responsibilities

Ms. Thomas stated the two bills have been presented to Representative Livingston who has tentatively agreed to sponsor them. She concluded by noting the ASRS is currently working with legislative Council to open the bill folders.

4. Presentation, Discussion, and Appropriate Action Regarding the ASRS Investment Program Updates

Mr. Karl Polen, Chief Investment Officer opened the topic by providing the fiscal year to date returns of approximately 6% and total assets of approximately \$39.2 billion. He noted that total fund positioning reflects caution about the potential impact of rising rates and is therefore overweight credit, underweight rates and slightly underweight real estate. The slight overweight in equities is due to outsize returns in equities and that overweight may be trimmed in coming months in light of stretched valuations. Mr. Polen then noted that one year returns for the period ended September 30 were 13.95%, which is 49bp higher than

the ASRS benchmark. The performance compared to benchmark improved 60bp compared to the prior quarter primarily due to improvements in the equity portfolio compared to the prior period, which underperformed after the Brexit vote. Mr. Polen reported that the fund continues to benefit from outperformance in its private debt, public fixed income and real estate portfolios. He then noted that ASRS is proceeding with changes in its public equity portfolio to defund active managers and replace them with style factor based approaches, which are expected to contribute to excess performance relative to the benchmark, and which can be implemented at much lower cost. Finally, Mr. Polen noted that the risk report from MSCI showed that ASRS risk is closely tracking the benchmark portfolio noting that the recent uptick in the measured risk of the portfolio is not due to any portfolio actions, but simply changes in the market.

Mr. Polen then responded to questions from the Board relating to public equity changes as they relate to active management.

5. Presentation, Discussion, and Appropriate Action Regarding the ASRS Comprehensive Annual Financial Report (CAFR) for Fiscal Year 2017

Mr. Jason Ostroski, CPA, CliftonLarsonAllen Audit Manager, introduced himself to the Board and spoke on behalf of CliftonLarsonAllen, LLP, the ASRS' external auditor. Mr. Ostroski presented an unmodified Independent Auditor's Opinion for the fiscal year ending June 30, 2017, on the ASRS financial statements that collectively comprise the ASRS' financial statements in the Comprehensive Annual Financial Report (CAFR). Mr. Ostroski noted an addition to this year's auditors report is the GASB 74, which relates to the Health Care Plans. Regarding the Independent Auditors' Report on Internal Control Mr. Ostroski reported there were no material weaknesses or significant deficiencies identified during the audit. Mr. Ostroski further noted the requirements and standards of GASB 74. Additionally, Mr. Ostroski noted that the accounting estimates which are focused on alternative investments and actuarial information including the pension and the health plans were determined to be reasonable.

Mr. Ostroski reported, as in the past audits, it was a pleasure to work with staff including the transition from the previous Chief Finance Officer (CFO).

Further Mr. Ostroski reported no uncorrected misstatements or corrected misstatements, therefore no adjusted journal entries were reported during the audit.

Mr. McCarthy took a moment to congratulate staff on their great work. Mr. Matson then asked Ms. Erin Higbee, CFO and Mr. Jeremy Pond, Controller, to stand up so that he could recognize them as key staff members in the preparation of this audit.

6. Presentation, Discussion, and Appropriate Action Regarding the ASRS Valuations

Mr. Paul Matson opened the topic by stating the purpose of performing the ASRS valuations on a yearly basis is to measure liabilities, the funded status, and primarily to set the contribution rates. He then turned the presentation over to Mr. Ryan Falls and Mr. Paul Wood of Gabriel, Roeder, Smith and Company (GRS) who were in attendance and summarized the results of the 2017 ASRS valuations.

a. The Pension Plan and Health Insurance Valuation

GRS addressed the Board regarding the ASRS Pension Plan and Health Insurance Valuation. They presented charts summarizing the contribution rates and the funded status. The resulting contribution rate is 11.64% for each the employee and employer. This represents an increase from last year's contribution rate of 11.34%. GRS presented their analysis including the implementation of the recommendations resulting from the Experience Study which was presented to the Board at its October 27, 2017 meeting. The resulting funded status of the Plan as of June 30, 2017 is 70.5%.

b. The System Valuation

GRS provided information regarding accrued liabilities, market value of assets and funded status for the System. The resulting funded status of the System as of June 30, 2017 is 79.6%.

c. The Long Term Disability (LTD) Valuation

GRS addressed the Board regarding the ASRS LTD Valuation. The resulting contribution rate is 0.16% with the experience study changes phased in, which results in no increase from the current rate, and would be 0.18% if there was no phase in. The resulting funded status of the LTD Plan as of June 30, 2017 is 80.4%.

d. Actuary's Recommendation Regarding 13th Checks for Retired System Members

Based on the results, there will be no addition to the 13th check or supplemental credit balances.

e. The alternate Contribution Rate (ACR)

GRS addressed the Board regarding the ASRS aggregate results and Alternate Contribution Rate (ACR) which is the amount employers pay when they rehire retired ASRS members. The calculated ACR is 10.53%, consisting of 10.47% for the Plan and 0.06% for LTD. This is an increase from last year's ACR of 9.49%.

GRS responded to questions from the Board regarding the results of the Experience Study as it relates to unfunded liability.

In response to a question by Mr. Hillyard on current, past, and future expectations with respect to changes in unfunded accrued actuarial liabilities, Mr. Matson elaborated on the changes of the factors that contributed to the change in the current unfunded liability. He discussed three major factors that contributed as the changes in the mortality table, the reduction in the actuarial discount rate, and the change in actuarial methodology, in addition to the pre-funding of the PBI.

Mr. McCarthy asked Mr. Matson to elaborate on the recommendations presented for the LTD program. Mr. Matson presented two options – a phased in option and a non-phased in option - with the resulting contribution rates for each the employee and the employer with regard to the LTD Program. The consensus of the Board was they agreed with the Director's recommendation of phasing in the LTD changes resulting in a contribution rate of 0.16%.

The Board expressed their appreciation to Mr. Falls and Mr. Wood for the work they put into the presentation.

Motion: Mr. Clark Partridge moved to accept the following:

- a. Accept the actuarial valuation report of the Plan as presented with the resulting contribution rates of 11.64% for each the employee and employer.
- b. Accept the System Actuarial Valuation as presented.
- c. Accept the Actuarial Valuation of the LTD Program as presented and phase in the impact of the changes consistent with the method used for the Pension Plan, with the resulting contribution rate of 0.16% for each the employee and employer.
- d. Accept the Actuary's recommendation to not provide an additional 13th check for retired system members.

Mr. Jim Hillyard seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 1 excused, and 2 vacancies, the motion was approved.

7. Presentation, Discussion, and Appropriate Action Regarding Delegating LTD Appeals to the ASRS Board Appeals Committee

Mr. Matson stated the ASRS' Board Appeals Committee and has the right to delegate appeals to the Appeals Committee. However, the statute did not allow the Board to delegate LTD appeals to that committee. The statute has now been remedied to allow the Board to delegate LTD Appeals to the Appeals Committee under Article 2.1.

Motion: Mr. Michael Miller moved to delegate the responsibilities added to A.R.S. § 38-714(E)(1) by Laws 2017, Chapter 105 to the ASRS Board Appeals Committee. Mr. Michael Lofton seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 1 excused, and 2 vacancies, the motion was approved.

8. Presentation, Discussion, and Appropriate Action Regarding Director's Report as well as Current Events

Mr. Paul Matson stated he had nothing further to add regarding the Director's Report, but would answer any questions the Board may have regarding the report; there were none.

9. Presentation, Discussion, and Appropriate Action Regarding Board Self Evaluation Material Distribution

Mr. McCarthy announced to the members of the Board they were provided a packet with Board Evaluation information and requested they be submitted prior to January 31, 2018.

10. Presentation and Discussion Regarding Informational Updates from Prior and Upcoming Committee Meetings

a. Operations, Audit and Legislative Committee (OALC)

Mr. Clark Partridge announced the next OALC meeting will be held January 3, 2018.

b. Investment Committee (IC)

Mr. Clark Partridge announced the next IC meeting is scheduled to be held on December 15, 2017.

c. Appeals Committee (AC)

Mr. Jim Hillyard announced the next AC meeting is scheduled to be held on December 12, 2017.

11. Board Requests for Future Agenda Items

No requests were made.

12. Call to the Public

There were no requests made.

13. The next regular ASRS Board meeting is scheduled for Friday, February 23, 2018 at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board Room, Phoenix, Arizona.

Mr. McCarthy noted the next Board meeting is scheduled for Friday, February 23, 2018 at 8:30 a.m.

14. Adjournment of the ASRS Board

Motion: Mr. Michael Lofton moved to adjourn the December 1, 2017, Board Meeting at 9:52 a.m. Mr. Jim Hillyard seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 1 excused, and 2 vacancies, the motion was approved.

Respectfully Submitted by:

Alicia Guzman
Board Administrator
ARIZONA STATE RETIREMENT SYSTEM